STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

IN RE:	)	
	)	
MIDAMERICAN ENERGY COMPANY	)	DOCKET NO. 01-0696
	)	
Proposed general increase in gas rates	)	

REPLY BRIEF
OF
MIDAMERICAN ENERGY COMPANY

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NOW COMES MidAmerican Energy Company (MidAmerican or Company) and respectfully submits its Reply Brief in the above-captioned proceeding.

II. OPERATING EXPENSES AND REVENUE

B. CONTESTED ISSUES

1. Uncollectibles Expense

MidAmerican first notes that the statement in the Citizens Utility Board (CUB) Initial Brief that "MidAmerican is currently requesting an increase of almost $500,000 (or 80%) more in uncollectible expenses than that approved in the 1999 rate case" contains no citation to the record. This is understandable as the statement is incorrect. MidAmerican notes that the total pro forma amount originally requested (not simply the increase) is less than $500,000. [See, e.g., ICC Staff Ex. 1.0, Schedule 1.1]. Furthermore, in rebuttal testimony MidAmerican accepted, for purposes of this docket, Staff's adjustment which adjustment was based on a five-year weighted average ratio of uncollectible expense to revenue. [MidAmerican Exhibit 14.0 at 4].

CUB proposed instead to throw out the actual uncollectible expense experienced in the test year, and average only the 1998 and 1999 uncollectible expense, calling the level experienced in the winter of 2000 – 2001 an anomaly. [CUB Initial Brief at 10]. Whether or not it is obviously remains to be seen. However, it is indisputable that this is a cost actually incurred by MidAmerican that should be recognized in this case, even if only as part of a five-year weighted average ratio of uncollectible expense to revenue. For purposes of this docket, the Commission should accept Staff's recommendation on this issue.

2. Incentive Compensation

MidAmerican renews its request to include $353,000 of incentive compensation expense in income statement and $18,000 of this expense in rate base in the revenue requirement to be set in this case. This amount is equal to almost eleven percent of its total salaried wage expense that is allocated to the Illinois gas jurisdiction. MidAmerican has shown that its employees are paid salaries (consisting of both base and incentive compensation) that are at the average of their respective labor markets, and that incentive compensation is a necessary component of compensation in today's energy industry. MidAmerican has also presented evidence showing that in order to receive incentive compensation, its employees must achieve goals that relate to their individual jobs, and that many of the individual goals result in improved company performance. Staff has not presented evidence that either the level of wages or the level of MidAmerican's incentive compensation expense is unreasonable. Instead, Staff's argument can be distilled as follows: MidAmerican's employees work to support corporate financial goals. [Staff Exhibit 1.0 at 18]. Their work towards corporate financial goals supports the shareholders and not the ratepayers. [Id.]. As long as an incentive compensation plan includes corporate financial goals, other aspects of an incentive compensation program, such as the recurrence of the expense and the fact that employees are paid at labor market averages are irrelevant. [Staff Exhibit 7.0 at 6; Tr. 60-61; 73-74]. However, there are no corporate financial performance goals in MidAmerican's performance incentive plan, so Staff's argument is misplaced. Instead, the Commission should rely on the evidence presented by MidAmerican and permit MidAmerican to recover its salaried labor costs in this case.

Following is MidAmerican's response to the arguments made by Staff in its Initial Brief filed in this docket.

Financial goals. At the foundation of all of Staff's arguments is the objection that MidAmerican's program is based on corporate financial performance. Beginning on page 4 of its Initial Brief, Staff states "[t]he record is clear that financial goals are a part of the Company's Plan." The record is not as clear as Staff would like the Commission to believe. Indeed, Staff has not been able to find a direct reference to corporate financial goals in the Performance Incentive Plan ("Plan") and instead must rely on indirect references for its conclusions. [Staff Exhibit 1.0 at 16-17]. Staff acknowledges that per employee payout is based on performance of the employee (and not on the achievement of a corporate financial goal).[1] However, on pp.4-5 of its Initial Brief, Staff points to a provision in the Plan that bases the

[1] On page 5 of its Initial Brief, Staff states that it "…does not dispute that individual employee goals determine payout per person, but this circumstance does not negate the fact that earnings affect overall amounts available for these payouts." This statement supports Ms. Sammon's testimony that MidAmerican's incentive compensation programs are based on individual goals, **not** corporate financial performance goals. [MidAmerican Exhibit 13.0 at 5, 11; Exhibit 13.2]. It is, however, the first time that Staff has acknowledged that MidAmerican's Plan is based on individual goals. In the event that Staff will still rely on the argument that the Plan document for the Performance Incentive Program states that employees work towards individual goals "…that support corporate and organizational unit goals," MidAmerican would remind the Commission that an organization whose employees are working towards individual goals that are not based on the perceived needs of the greater organization will be doomed to fail. In fact, it is difficult to imagine any work by a corporate employee that would be worthy of compensation (either in the form of base or incentive pay) that does not support corporate goals.

overall Plan payout to all participants on "company performance" as clear evidence that earnings, or corporate financial goals, affect total payouts. This reference does not base any employee's award on achievement of any corporate financial goals. Instead, it is a provision that is intended to protect the Company from being required to make a payout during a period of poor overall financial performance.

The reason why Staff opposes incentive compensation plans that are based on corporate financial goals is the perceived "circularity effect." The circularity effect allegedly occurs when a rate increase is granted that is larger than it would otherwise have been because of efforts of employees to work towards corporate financial goals which double as their incentive compensation goals. Such an increase in earnings produced by a rate case is seen as enhancing a utility's ability to pay incentive compensation. [Staff Exhibit 1.0 at 18].

For a circularity effect to exist, employees should be focused on achievement of corporate financial goals, which purportedly benefit shareholders at the expense of customers. This was the case for the Illinois Power employees in the case cited by Staff, at pp. 5-6 of its Initial Brief where the incentive plan's goals for all employees were earnings per share and reduced O & M expenses. *Illinois Power Company,* Docket No. 93-0183 at 52. MidAmerican's employees do **not** receive incentive compensation based on the accomplishment of corporate financial goals. As Staff has acknowledged, the MidAmerican Plan is different from the Illinois Power plan. MidAmerican employees work to achieve individual goals, and it is accomplishment of individual goals that affect their individual payout. [MidAmerican Exhibit 13.1]. The **only** impact of corporate performance (which Staff extrapolates to be the product of corporate financial goals) on Plan payout is on the total amount that will be available to pay all employees as a group. This provision is logical and necessary for reasons that have nothing to do with incenting corporate financial performance. If a company had a bad year, whether or not it had corporate financial goals, there would be no money to pay out. Without some provision tying total corporate payout to corporate performance, employees could argue that they had an expectation, if not a legal right, to an incentive compensation payout.

MidAmerican does not agree with Staff's oft-repeated circularity argument because there are myriad ways to create earnings other than via gas rate increases. However, even if the Commission considers the "circularity effect" to be a valid ground for disallowance of incentive compensation expense, there must be more evidence linking incentive compensation awards to performance towards corporate financial goals than Staff has been able to find in MidAmerican's Performance Incentive Plan. Staff's argument that two statements in MidAmerican's incentive compensation plan can be interpreted to mean that the Plan is based on corporate financial performance, is insufficient grounds for disallowance of MidAmerican's incentive compensation expense.

Other goals. On page 6 of its Initial Brief, Staff lists a number of MidAmerican's non-financial corporate goals that are unrelated to Illinois. MidAmerican acknowledges that these goals are not related to the Illinois gas jurisdiction. Because the goals are not related to the Illinois gas jurisdiction, the payroll cost[2] associated with work towards the goals is not reflected in the Illinois gas jurisdictional costs. There is no argument made by Staff that the allocation process used by MidAmerican in this case is flawed. Nevertheless, on page 6 of its Initial Brief, Staff contends, "achievement of these goals remains a *contributing factor* to incentive compensation expense included in the present requirement." (Emphasis supplied). This statement is incorrect, misleading and inconsistent with Staff testimony. Staff's accounting witness testified that she found nothing improper in MidAmerican's jurisdictional allocations

[2] MidAmerican allocates both base and incentive payroll costs to the appropriate jurisdiction.

during the audit of MidAmerican's books. [Tr. 65-66]. Also, the base payroll expense included in Ms. Hathhorn's proposed revenue requirement does not reflect disallowance of non-jurisdictional costs. Since about 90 percent of employee compensation expense is in the form of base pay, it would seem that some portion of that expense should also have been proposed for disallowance by Staff if improper allocations had been found. The Commission should also recognize that under Staff's "contributing factor" test, no expense could be allocated between jurisdictions in setting rates, because the extra-jurisdictional costs would always be a "contributing factor" to the jurisdictional costs. It appears that Staff is simply trying to sway the Commission to disallow legitimate expenses.

Staff also argues that some of the individual goals are little more than tasks employees perform as part of their normal duties. Staff bases this argument on three out of the roughly 100 individual goals reflected in Exhibit 13.2. Staff contends that since the revenue requirement already includes annual base pay increases, employees have received adequate awards for performance of these goals.

Exhibit 13.2 demonstrates that only a very small number of the individual goals are associated with "normal" job duties. The majority of individual goals go beyond "normal work." For those employees with goals that appear to be part of their normal job, MidAmerican would ask the Commission to consider the powerful impact that incentive compensation can have on improving performance. If an employee has a poor attendance record, will that employee perform better if he or she receives about the same base pay cost of living increase as other employees, or will his or her performance be incented if the employee understands that attendance difficulties will place a portion of pay at risk? This example illustrates the powerful effect that incentive compensation can have on performance.

Ratepayer Protection. Staff refuses to label incentive compensation expense recurring, despite the 6-year history of an incentive compensation program. [MidAmerican Exhibit 13.0 at 8-9; MidAmerican Exhibit 13.3]. At page 7 of its Initial Brief, Staff continues to argue that MidAmerican's 6-year incentive compensation history should be ignored because of the possibility incentive compensation pay may decrease and because of the presence of the disclaimer provision in the Performance Incentive Plan. [Tr. 61]. Ms. Hathhorn admitted that any other expense with a similar track record would be considered recurring, and that the presence of the disclaimer provision is the aspect of the incentive compensation program makes its costs different from others. [Tr. 62].

Ms. Sammon, MidAmerican's Vice President of Human Resources has testified that the disclaimer provision is not unique to the incentive compensation plan; it is common to employee benefit plans. [MidAmerican Exhibit at 12-13]. Other MidAmerican benefit expenses that are fully included in Staff's proposed revenue requirement, such as health care and pensions, are based on plans that include disclaimer provisions. As the Commission has held, disclaimer provisions are financially sound. *MidAmerican Energy Company,* Order in Docket No. 01-0444, page 9.

MidAmerican's incentive compensation costs cannot be rejected on the basis of inadequate ratepayer protection. The program has been in effect for six years; MidAmerican's Vice President of Human Resources has testified to MidAmerican's commitment to incentive compensation. The disclaimer does not make the expense non-recurring; it merely provides appropriate financial protection to the Company in the event of employee expectation claims. Staff's argument that incentive compensation should be singled out and treated differently from other employee benefit expense with equal likelihood of non-recurrence should be rejected by the Commission.

MEC's analysis. Staff argues that MidAmerican has not provided support for ratepayer benefits flowing from incentive compensation. It is undisputed that MidAmerican pays labor market average wages; it is not clear what other indication of ratepayer benefits is needed. To support ratepayer savings, MidAmerican has provided Staff with documentation, which Staff has rejected, claiming that it reflects only total company savings, and not just the Illinois gas allocation. However, there is no question that the incentive compensation program resulted in these savings.

When she was cross-examined, Ms. Hathhorn's position regarding savings produced by incentive compensation became clear. She is not interested is reviewing and analyzing savings attributable to incentive compensation. She would require a utility to offset incentive compensation expense with equal savings, regardless of the benefits of incentive compensation. [Tr. 55-59]. If the Commission truly believes that incentive compensation holds the potential to provide benefits in terms of improving employee performance and reducing costs as it stated in its Order issued in *MidAmerican Energy Company*, Docket No. 01-0444 at page 8, it must reject Staff's position. There will be no reason for utilities to adopt incentive compensation if they have to give up an equal amount of expense in the form of alleged "savings"[3] .

Labor-market pay. Staff states in its Initial Brief at pp 10-11:

> Staff is not concerned whether MEC's plan produces labor-market average wages. Staff only considers which party-shareholders, ratepayers, or both – should fund ICP expense.

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3. This is particularly true when a company could return to a base pay-only system that would not be scrutinized by the Commission.

It appears from this statement that Staff does not dispute the record evidence that MidAmerican's total salary expense is at labor market averages. Ms. Sammon has testified that the compensation program pays labor market average wages. [MidAmerican Exhibit 13.0 at 5-7]. She indicates that this conclusion has been verified by a human resources consultant. [Id.]. She also provided Staff with the materials that her department has used to verify that individual positions are paid at labor market averages. [Staff Exhibit 7.0 at 6-7]. She explained the process that was used to make this determination. [Tr. 44-45].

It is not clear whether Staff ever attempted to independently evaluate this wage data. While Ms. Hathhorn, a certified public accountant, testified that she did not know what "labor market average wages" were for MidAmerican, that she could not follow MidAmerican's methodology, and that MidAmerican did not provide any summaries of the data, she also admitted that she did not ask for any help from MidAmerican once she received the studies. [Tr.62-64]. She has also testified to the limited importance of these surveys, stating that she thought labor market average wage studies were "of no consequence." [Staff Exhibit 7.0 at 6].

The only credible evidence in the record supports the conclusion that MidAmerican pays its employees labor market average wages that consist of base and incentive pay. Staff's proposed disallowance should be rejected so that MidAmerican can recover the costs that it would incur to pay its employees labor market average wages.

The Commission has recognized that incentive compensation holds potential benefits for utilities by improving employee performance and reducing costs. MidAmerican's incentive compensation program fulfills this potential, and the properly allocated incentive compensation expense should be included in the revenue requirement approved in this proceeding. The incentive compensation program provides benefits for all salaried employees (not just a highly compensated subgroup), is based on achievement of individual (not corporate financial) goals and combines base and incentive pay to allow employees to earn labor market average wages.

MidAmerican recognizes that in its latest residential DST case the Commission rejected incentive compensation expense in the interests of congruity with past decisions and state-wide uniformity in electric ratemaking. These interests are not determinative here. First, this case is not one of a state-wide series of cases as was the DST case. Second, at least one other gas utility includes incentive compensation in its rates. MidAmerican's program should be independently reviewed in this case and all of its labor market average wage costs should be included in the revenue requirement established in this case.

3. Cordova Revenues

In Staff's initial brief, it suggested that MidAmerican either was aware, or should have been aware that because Staff issued a data request concerning the second customer charge seven weeks before it filed rebuttal testimony that the subject of the data request was a potential issue in the case. [Staff Initial Brief at 12]. Is Staff seriously alleging that every data request of the hundreds issued in the course of a typical rate case should put the respondent on an "alert" status, possibly beginning to compose a reply to testimony not yet filed? MidAmerican agrees with Staff that its witness drafted that data request soon after filing direct testimony; MidAmerican finds, however, that this timing underscores when the data request was not filed: in the four-plus months between MidAmerican's filing on October 19, 2001 and the filing of the Staff's direct testimony on March 1, 2002.

Staff's initial brief also references that Staff received MidAmerican's response to its data request 27 days before Staff filed its rebuttal testimony. [Staff Initial Brief at 12].

Inexplicably omitted, however, is why Staff did not then file supplemental direct testimony at that time.

One allegation made in Staff's initial brief must be rebutted because it is simply incorrect. The following was listed as the third reason to dismiss MidAmerican's objection to the timing of this issue:

> Since MEC witness Tunning was aware, or should have been aware, of the reasoning behind Staff's adjustment to Cordova revenues prior to filing his own direct testimony…

This support for Staff's position must also be dismissed as MidAmerican witness Tunning filed his direct testimony on October 19, 2001, which, in turn was four-plus months before Staff filed direct testimony and Staff's testimony itself preceded the issuance of the data request. In fact, MidAmerican's <u>rebuttal</u> testimony had been on file for over three weeks before this issue surfaced in Staff's rebuttal testimony.

Therefore, MidAmerican requests that Staff's proposed adjustment be rejected.

III. <u>RATE BASE</u>

B. <u>CONTESTED ISSUES</u>

1. <u>Incentive Compensation</u>

Please see MidAmerican's argument under Section II. B. 2.

V. <u>COST OF SERVICE</u>

A. <u>CLASS-BY-CLASS PEAKS: 85 HDD VS. 90 HDD</u>

Staff's initial brief mentions that MidAmerican's system-design peak HDD has yet to occur. [Staff Initial Brief at 27]. MidAmerican posits that such non-occurrence is a good thing. A peak HDD at or above the design of the system would likely have serious impacts on the reliability of the system. MidAmerican's purpose in designing the system is to maintain reliability under the most extreme conditions, so, by definition, the costs incurred must support a capability greater than even the extreme conditions actually experienced.

The cost of service study should accurately calculate and allocate the costs of the system.[4] There is no contention that the costs incurred to design, build and maintain the system to MidAmerican's design day specifications were too great or should be disallowed. Therefore, it would be an abdication of duty to assign these costs on a basis different than for which they were incurred.

The rationale proposed by Staff witness Luth (that the peak should be set based on observed conditions) can be a moving target; for example, next winter may set a new peak. Staff argues that the 85 HDD number is appropriate for two reasons: 1) it is the all-time lowest temperature recorded in MidAmerican's Illinois service territory, and 2) this peak is closer to the test year peak. [Staff Initial Brief at 27]. MidAmerican notes that these are <u>not</u> independent reasons; the second simply depends on the truth of the first (deductive reasoning). Staff also supports use of 85 HDD because the result would advantage lower load-factor customer classes more. [Staff Initial Brief at 27]. MidAmerican believes that if there is a reasoned basis to advantage low load-factor customers, that change needs to be brought forward and supported in the rate design step of this process, not merely thrown in to muddy the waters of the equity of the cost of service study.

B. <u>CLASS ALLOCATION FACTORS FOR METERS, SERVICES, AND REGULATORS</u>

Staff argues that the results of the cost of service study used in the last MidAmerican gas rate case as compared to the results of the current cost of service study in regard to relative

[4] One of the goals and objectives of public safety regulation is to ensure equity. This means fairness to consumers and investors so that "the costs of supplying public utility services is allocated to those who cause the costs to be incurred." 220 ILCS 5/1-102(d)(iii)

weightings for services, meters and regulators should not be significantly different, in that there has not been a significant addition to the customer base. Staff would require use of the weightings from the past case as it does not believe MidAmerican has adequately explained why the two are different. [Staff Initial Brief at 28 – 29].

An analogy to Staff's argument would be to say that MidAmerican has not, to Staff's satisfaction, explained why a number derived from a review of generic apples is different from a number derived from a review of Gala apples grown in the State of Washington. Therefore, it is a very good thing that Staff is not the trier of fact in this docket.

MidAmerican would agree that if it had performed a calculation using a specific subset of numbers and the result of that calculation was accepted in the last case and if in the instant case it stated it used that same subset as it currently existed and the result of the calculation differed from the previous calculation, MidAmerican should explain, to the best of its knowledge, why the two differed.

However, that is not the case here. As MidAmerican witness Rea explained, for purposes of this cost of service study MidAmerican used data specific to the Company's system. [MidAmerican Exhibit 8.0 at 2 – 3]. In contrast, in the prior case, the weighting factors for services, meters and regulators did not focus on data specific to the Company; instead the weightings were supported by the general experience of the outside witness. [MidAmerican Exhibit 15.0 at 25]. In other words, comparing the weightings from the prior docket to the current would be akin to comparing weightings based on generic apples versus ones based on Washington State Gala apples. We could ask why the results are different but even if a conjecture were possible, what value would it have?

The correct question for the current docket is whether the cost of service study offered by MidAmerican uses the data best tailored to give the result that is most relevant to MidAmerican's system. If this was done, the results of the cost of service study will best reflect the cost causation goals of the study and, thus, best serve the statutory goals. [See, e.g., 220 ILCS 5/1-102(d)(iii)]. Because the current weightings used by the Company are calculated using current empirical data directly relevant to the Company's customers, the answer to this ultimate question is, of course, an affirmative. Therefore, as MidAmerican's weightings best reflect cost causation for MidAmerican's service territory, the Commission should approve their use in this docket.

Staff also argues that it is difficult to determine what relationship the typical installations used in the allocation factor determination have to installations in the field. [Staff Initial Brief at 29]. For some reason, Staff still appears to believe that the allocation factor inputs must match embedded costs to be useable. Yet in cross-examination, Staff witness Luth agreed that if a Company did not have embedded cost information, some sort of proxy must be used. [Tr. 186]. MidAmerican has used the methodology used here to: 1) develop the Industrial Meter allocation in this docket (without demur from Staff), 2) develop allocation factors in MidAmerican's delivery service case concluded in March 2002 and 3) to develop allocation factors in certain of its and its predecessor's Illinois rate cases. [MidAmerican Initial Brief at 38]. Furthermore, the NARUC Gas Rate Design handbook lists it as an acceptable methodology. [MidAmerican Exhibit 19.0 at 3].

C. ALLOCATION OF MARKETING COSTS: MARGIN VS. THROUGHPUT

The primary rationale to include marketing costs in revenue requirements is that they act in the future to increase the sales over which the Company's fixed costs can be spread, thus lowering rates (costs divided by sales) for all customer groups. Staff's proposal to allocate marketing costs only by throughput is flawed. Throughput only recognizes energy usage. Rates are both a function of the amount of gas sold to each customer group and the costs allocated to each group. Together, this combination results in margin. Since the impact of inclusion of these costs is to someday reduce rates, it is appropriate that margin is used as the basis upon which these costs are allocated.

D. APPROPRIATE ALLOCATOR FOR GAS MAINS COSTS TO THROUGHPUT AND PEAK DEMAND FUNCTIONS.

MidAmerican agrees with the contention of CUB witness Ross that capacity costs associated with gas mains decline on a marginal basis. MidAmerican also agrees that the average and peak methodology does not capture this declining marginal cost distinction. MidAmerican does not agree, however, with his conclusion that the system load factor as the allocator of the costs of mains between the throughput and peaking functions should be discarded.

CUB's recommendation that the allocation directly reflect the idea that capacity costs are lower than throughput costs is flawed because it is not taken to its logical conclusion, as pointed out by MidAmerican witness Rea. [MidAmerican Exhibit 15.0 at 8]. Taken to its logical conclusion, the CUB proposal has many of the hallmarks of a minimum system approach to a cost of service study, where different levels of costs are allocated, in turn, to customer groups on 1) the basis of the number of customers in each, 2) throughput, and 3) peak demand. CUB does not have a cohesive, logical methodology because it simply ignores those levels that are properly allocated as customer costs. [MidAmerican Exhibit 15.0 at 9 – 10]. This criticism of the CUB approach was supported by Staff witness Luth, [Tr. 188 – 189], who also used the average and peak methodology MidAmerican advocates to allocate mains costs to the throughput and peak demand functions. [MidAmerican Exhibit 19.0 at 11]. Therefore, the Commission should accept this allocator.

VI. RATE DESIGN

A. RATE 60

1. Customer Charge

Cost of Service Study

CUB continues to argue that common costs, i.e., costs that pertain in some form to all aspects of the utility business and not one particular function, should be removed from the calculation of the customer charge as they cannot easily be classified as customer-related and do not directly vary with the number of customers. [CUB Initial Brief at 4]. CUB's brief omits from this discussion the rejoinder made by MidAmerican: while it can be said that the specific costs CUB has removed in its calculation of a customer charge for Rate 60 do not vary with the number of customers, to the same extent it can be said they do not vary with throughput, peaking or gas costs. [MidAmerican Exhibit 15.0 at 3]. In fact CUB's own witness, Brian Ross, made this exact point in his direct testimony. [CUB Exhibit 1.0 at 8]. It is instructive that CUB does not argue that the common costs it has stripped from its customer charge calculation more properly belong somewhere else, they simply argue where those costs should not be.

By charging overheads related to a particular function or service on the same basis as the direct costs for that service, customers receive the appropriate price signal. The customer charge should represent a bundle of services that every customer purchases and uses in roughly equal amounts (within a rate class) regardless of the amount of gas they use. [MidAmerican Exhibit 15.0 at 4].

CUB's argument that MidAmerican's proposed $12.00 customer charge for Rate 60 is out of line with other Illinois gas utilities was also shown to be flawed. As MidAmerican witness Rea pointed out, CUB chose to tell only part of the story as most, if not all, of those utilities with the $6 - $10 range have blocked rates with volumetric charges for low-use customers at least twice as high as the Company's proposed rate in every case. [MidAmerican Exhibit 15.0 at 11].

Rate Design

The Commission should adopt MidAmerican's proposal to set the Rate 60 customer charge at "the cost of service level approved by the Commission, (rounded to the nearest dime, not to exceed $12) and set the energy charge to recover any remainder of the class revenue requirement." [MidAmerican Exhibit 20.0 at 3].

CUB's comments on MidAmerican's proposed design of Rate 60 (Residential Service) were largely addressed in MidAmerican's initial brief. CUB's argument that MidAmerican's proposal is "inconsistent, fails to implement basic rate design principles, and results in an unreasonable and discriminatory customer charge" are all unfounded.

CUB complains that "although MidAmerican sponsors separate witnesses for cost of service issues and for rate design issues, it relies only on COSS results to set the Rate 60 rate design." [CUB Brief at 3]. While rate design may take into account other issues, one would expect rate design to be based on cost of service results in the absence of overwhelming reasons not to do so. CUB provides no credible or objective reason not to base rate design on COSS results, and in doing so ignores the statutory goal that rates be based on cost causation as reflected in a cost of service study.

CUB argues that MidAmerican's Rate 60 rate design is discriminatory relative to its proposed design of Rate 70. Company and Staff have already addressed this issue fully. The Company testified that the Rate 70 customer charge should be less than the average cost of service for the class as a whole because customer-related costs for small Rate 70 customers are less than the average for the class as a whole. [MidAmerican Exhibit 16.0 at 6; MidAmerican Exhibit 20.0 at 5]. No evidence suggests that the same could be said for Rate 60, and in fact, the record shows that variation of usage between small and large customers is dramatically higher in Rate 70 than Rate 60. While CUB properly notes that differences in cost causation within a single rate class should be considered in rate design [CUB brief at 5], CUB has provided no specific evidence that such differences in cost causation actually exist within Rate 60. CUB notes that variations in usage exist between Rate 60 customers [CUB brief at 6], but offers no evidence that these variations in usage result in any variations in customer-related costs. On the other hand, MidAmerican has testified that variations in usage among Rate 70 customers do result in variations in cost. [MidAmerican Exhibit 20.0 at 5]. Staff has agreed that "low-use Rate 70 customers have less complex and less expensive connection costs than high-use customers, making the lower customer charge appropriate." [Staff brief at 33].

Staff proposes to move the Rate 60 customer charge toward cost of service levels. [Staff brief at 32]. While Staff's proposal would move the customer charge toward its appropriate level, Staff has not shown a compelling reason not to set the Rate 60 customer charge at the full cost of service amount.

2. <u>Volumetric Distribution Energy Charge</u>

Both Staff and MidAmerican agree that any of the Rate 60 revenue requirement not recovered via the customer charge should be recovered via the energy charge. The Commission should approve this method of determining the Rate 60 energy charge.

B. RATE 70

1. <u>Customer Charge</u>

The Commission should approve the $19 monthly charge accepted by both Staff and MidAmerican.

2. <u>Distribution Energy Charge: Transportation and Sales Service Charges</u>

MidAmerican has accepted Staff's calculation of the Rate 70 energy charge, except that the overall Rate 70 revenue requirement should be based on the Company's overall proposed revenues and cost of service study. In addition, MidAmerican proposes that the same energy charge be imposed on both sales service and transportation customers. As MidAmerican explained in its initial brief, any differences in the cost of serving sales and transportation customers need not be incorporated into rate design at this time. Staff's proposal would give significant rate <u>de</u>creases to certain transportation customers. [MidAmerican Exhibit 16.0 at 3]. This, in turn, would result in larger increases to other customers. The Commission need not exacerbate rate increases to certain customers in this case by approving Staff's proposed differential between sales service and transportation service rates.

3. Administration Charge

Both MidAmerican and Staff agree that a monthly Transportation Administration Charge of $85 should be applied to bills of transportation service customers. [MidAmerican Initial Brief at 6]. The Commission should approve the $85 charge.

4. Transportation Metering Charge

Both MidAmerican and Staff agree that a monthly Transportation Metering Charge of $18 should be applied to bills of transportation service customers on Rate 70 and 87, and that a metering charge of $11 should be applied to transportation bills on Rate 85. [MidAmerican Initial Brief at 7]. The Commission should approve the charges endorsed by MidAmerican and Staff.

C. RATE 85

Staff and Company disagree on the Rate 85 revenue requirement and on whether differing energy charges should be established for sales and transportation customers. These issues are not limited to the design of Rate 85 and have been discussed elsewhere in this brief. Company and Staff agree on the other aspects of Rate 85 rate design. The Commission should approve the design elements which have been accepted by both Staff and MidAmerican as well as MidAmerican's revenue requirement and energy charge design.

D. RATE 87

As with Rate 85, Staff and Company disagree on revenue requirement and cost of service issues, and whether differing energy charges should be established for sales and transportation customers. Company and Staff agree on the other aspects of Rate 87 rate design. The

Commission should approve the design elements which have been accepted by both Staff and MidAmerican.

E. RIDER 9 – FIRM STANDBY SERVICE

1. Appropriate Pricing for Standby Gas

MidAmerican and Staff disagree on two distinct issues regarding standby service: first, should the price of standby gas be based on a daily spot market index or on a monthly average price such as MidAmerican's Weighted Average Cost of Gas or its PGA? And second, if the price of standby gas is based on a spot market index, should a 10% adder be applied?

The Commission should base the price of standby gas on a daily index as MidAmerican proposes.

MidAmerican notes that this Rider is available to its transportation customers. Staff and MidAmerican do agree in reference to balancing services that when a transportation customer takes more natural gas in a day than it had contracted with its supplier to provide, this draw on MidAmerican's supply cannot be forecast by MidAmerican and that a good proxy for the cost of spot market purchases likely to be needed is a Gas Daily Index. [See, e.g., Staff Exhibit 6.0 at 5]. MidAmerican notes that like all gas consumed by customers, transportation and sales service alike, the gas used in the balancing service comes from MidAmerican's PGA portfolio. Staff witness Borden understands that these swings, where the Company is to pick up the "unpredictable differences between actual transportation customer usage and actual transportation deliveries to the Company's city-gate can affect the cost of gas to sales customers by forcing the Company to make unplanned market purchases." [Id.] Typically, a transportation customer's imbalance is just that difference between his actual usage and the amount of gas delivered by his supplier. In fact Mr. Borden further supports use of a spot market index for pricing this gas to transportation customers by noting that such prices when cashing out net monthly imbalances discourages systematic gaming of the PGA by transportation customers. [Id.] In other words, using the balancing service as a "supplier" of additional gas would be attractive to a customer when other sources of supply would be more expensive than the PGA rate, for example, when the alternative to secure additional gas for that day would be for the transportation customer to go to the spot market himself.

How does that situation differ from a transportation customer taking Firm Standby Service? It is true that when the Firm Standby transportation customer takes gas from MidAmerican, that gas is supplied through the PGA portfolio. But that is also the source of the gas for the balancing service described above that Staff agrees should be priced at spot. The Firm Standby tariff is designed to provide a "peace of mind" backup service for a transportation customer when his normal source of gas is unavailable. Because it provides at least as much value, if not more, than a customer making emergency purchases on the spot market, the basis for the price should be consistent. His use of Firm Standby is likely to be sporadic and known only at the last minute. [MidAmerican Exhibit 20.0 at 8]. Such usage is no more predictable than transportation customers' imbalances are. Thus, a customer opting for Firm Standby for a particular day may, like imbalances, affect sales service customers by forcing the Company to make unplanned market purchases. [MidAmerican Exhibit 16.0 at 16].

Furthermore, Firm Standby Service is meant to provide a safety net for transportation customers for those sporadic times when their own supply fails—it is not designed to be a free pass to circumvent the usual procedures to become a sales service customer. If the service is priced in the same fashion as is sales service, as Staff advocates, what is to prevent the transportation customer from remaining on this rate, until either the spot market or suppliers' rate offerings become more attractive? MidAmerican considers this as very similar to the gaming possibility Staff witness Borden wished to eliminate in the balancing service context by using a daily index rate as the basis for the charges there. MidAmerican's Rider No. 7, Transportation of Customer-Owned Gas, contains terms and conditions for transportation customers returning to sales service, including required notice periods and how long before one qualifies to switch from transportation to sales service. Using a WACOG rate for standby gas would effectively eviscerate those terms and conditions, by allowing the benefits of sales service under the terms of the Firm Standby Service rider.

Nor would MidAmerican’s proposal place an unfair burden on standby customers. Mr. Schaefer’s testimony reviewed in MidAmerican's initial brief shows that MidAmerican’s proposal is fairer to both standby and sales service customers than is continued pricing at the WACOG or PGA level.

For all of the reasons listed above as well as those in prior MidAmerican testimonies and brief, pricing for standby gas should be based on an after-the-fact index.

2. Application of an Adder to the Spot Market Index Price

A separate and distinct issue is whether an adder should be applied to any spot market index which is used to price standby gas. MidAmerican continues to recommend that an adder be applied to reduce the potential for any subsidies of standby customers by sales service customers. Witness Schaefer has testified that an adder would help ensure that the price charged for standby usage will not be less than the cost of providing that service. [MidAmerican Exhibit 16.0 at 17; MidAmerican Exhibit 20.0 at 13].

F. RIDER 8 – NON-CRITICAL DAY BALANCING OF CUSTOMER OWNED VOLUMES

1. Imbalance Tolerances

Staff continues to oppose changes in MidAmerican's existing balancing tolerances. The Commission should approve MidAmerican's proposed changes. MidAmerican's proposal would allow for broader consolidation of its tariffs. The resulting balancing provisions result in greater balancing flexibility to MidAmerican's transportation customers than if they were directly connected to an interstate pipeline. [MidAmerican Exhibit 16.0 at 18]. In other words MidAmerican will allow greater balancing flexibility to its customers than it itself receives from the pipeline.

2. Imposition of imbalance penalties when imbalance is in the opposite direction as the system net imbalance

Staff continues to argue that transportation customers should not incur imbalance charges when their imbalances are opposite to the net overall imbalance on MidAmerican's system. MidAmerican urges the Commission not to impose Staff's reversal of the practice which the Commission has previously found to be just and reasonable. Staff's brief notes that Mr. Borden "indicated that such daily imbalances may be beneficial to MEC…" [Staff Initial Brief at 45, emphasis added]. MidAmerican first notes that such balances cannot be beneficial to MidAmerican itself as such are flowed through the PGA, a fact conceded by Staff witness Borden in cross-examination. [Tr. at 117]. In contrast, MidAmerican witness Schaefer offered numerous examples such daily imbalances which would not be beneficial and would be harmful. [MidAmerican Initial Brief at 54 – 56].

Staff's brief continues to repeat errors which have been addressed previously by the Company. Staff contends "the Company must balance the system as a whole." [Staff Initial

Brief at 46]. But Mr. Schaefer testified that "MidAmerican does not balance its system as a whole; it must instead balance its system on specific interstate pipelines and at specific delivery points. The fact that a transportation customer's imbalance is in the opposite direction of the system net imbalance does not necessarily mean that the same customer's imbalance is beneficial or reduces costs." [MidAmerican Exhibit 20.0 at 15, emphasis added].

Ignoring the numerous examples provided by Mr. Schaefer, Staff contends "daily imbalances are important to MEC only as they relate to the total system imbalance," and that imbalances in the opposite direction as the system net imbalance "do not impose a cost upon MEC." [Staff Initial Brief at 46]. Mr. Schaefer provides many examples of situations where such imbalances do impose a cost on PGA customers. [MidAmerican Initial Brief at 54 ff.]. Since these costs are passed through MidAmerican's PGA, it is MidAmerican's sales service customers who would feel the impact of Staff's proposal. Even Staff has acknowledged that daily imbalances can have PGA ramifications that cannot be associated with any specific imbalance on any specific day. [Staff Exhibit 10.0 at 11].

The Commission should reject Staff's proposal and leave intact MidAmerican's existing Commission-approved policy of imposing balancing charges regardless of the direction of imbalance.

CONCLUSION

WHEREFORE, MidAmerican Energy Company respectfully requests the Illinois Commerce Commission issue an Order approving its natural gas service tariffs in accordance with the arguments contained herein.

Respectfully submitted,

MIDAMERICAN ENERGY COMPANY

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